



ASIAN DEVELOPMENT BANK
Economics and Development Resource Center

ASSESSING THE SOCIAL IMPACT OF THE FINANCIAL CRISIS IN ASIA

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November 1998

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Foreword

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After decades of remarkable performance, a number of economies in Southeast and East Asia were suddenly hit by a financial shock in the second half of 1997. What was initially thought to be a transitory malaise in the currency and equity markets has deepened into an economic crisis. Its severity is reflected in the abrupt and steep downturn of gross domestic product (GDP) growth in the affected economies. Negative social consequences are likely to persist long after the end of the financial crisis.

This note provides a broad survey of the social impact of the crisis, based on available data and work-in-progress under a Bank regional technical assistance study.¹

Channels of Transmission

Conceptually, six main channels through which the financial and economic crisis can exert adverse social impacts may be identified. These are labor markets (domestic and overseas), prices, assets, credit, and government budget.

First, unemployment is visibly rising due to business failures or retrenchment; alternatively, many firms are cutting wages, reducing employee benefits, or shortening working hours. Second, prices of imported goods or items with high import content are escalating. Third, asset values are lost owing to the collapse of stock and real estate markets, and lifetime savings are gone due to banking failures. Fourth, diminished collateral for loans along with high interest rates is constricting access to credit for investment or consumption. Fifth, government revenue is down, while a good deal of public expenditure is being diverted toward the restructuring of financial institutions and debt servicing. Finally, the demand for migrant workers throughout the region is declining, thereby hurting countries that rely on overseas labor markets for employment of their surplus labor and for worker remittances.

1. RETA 5799: Social Impact Assessment of the Financial Crisis in Selected DMCs.

Employment, Income, and Prices

The negative effects of the crisis on employment and income have intensified as the crisis has spread from the financial sector to other sectors. Table 1 shows the marked rise in unemployment rates in the afflicted economies. The numbers are indicative and probably mostly on the low side. As is well-known, the unemployment rate is often a vague measure of the employment problem in a developing economy. In times of crisis, unemployment is even more difficult to gauge. Thus, while unemployment in Indonesia is shown as 5 percent as of June 1998 in Table 1, it is estimated to be as high as 15 percent compared with 6.7 percent a year ago, and is expected to exceed 20 percent (about 20 million labor force members) by the end of the year. Likewise, Thailand's year-end jobless rate may be more than 6 percent. In terms of the overseas labor market, the deployment of migrant workers from the Philippines fell by 23.4 percent in the first quarter of 1998, compared with the same quarter of the previous year.

The employment problem also manifests itself as underemployment. A major indication is the increase in members of the labor force who are involuntarily working less than 35-40 hours per week. Other forms of underemployment are early retirement as part of company downsizing and cuts in real wages or benefits. In Mindanao (Philippines), a banana plantation labor union lost one third of its members, many of whom were subsequently rehired as contract workers at 27 percent lower pay and without any job security (World Bank 1998b).

Incomes in the informal sector are falling with weaker domestic demand and higher input prices. Moreover, informal sector labor force is expanding with the entry of the unemployed from the formal sector, resulting in sharply lower earnings per worker. Agriculture is likewise adversely affected by higher input prices (e.g., imported fertilizers and fuel), restricted credit, and weaker domestic demand. In the Philippines, small farmers in Luzon are reducing rice acreage owing to the prohibitive cost of credit needed to purchase fertilizers and other inputs. The agricultural workforce is swelling with the return of urban workers who have lost their jobs, resulting in diminished agricultural incomes per capita. Problems

Table 1. Unemployment Rates in Selected Asian Countries
(in percent)

	1993	1996	1998 ^a
China, People's Rep. of	2.6	3.0	3.1
Hong Kong, China	2.0	1.7	4.8
Indonesia	2.7	2.6	5.0
Korea, Rep. of	2.8	2.6	7.6
Malaysia	3.0	2.5	6.7
Philippines	8.9	7.4	13.3
Singapore	2.7	3.0	2.3
Thailand	1.5	1.1	4.4

^a Figures are as of June.

Sources: International Labor Organization, OECD, and United Nations data.

in agriculture have been exacerbated by the El Niño-induced droughts in Southeast Asian countries.

Steep currency depreciations have fueled sharp price increases. In Indonesia, annual inflation rate was reported at 79 percent in October 1998, led by prices of food and medicines. Double-digit inflation has also been reported in Thailand, averaging 8 percent for 1998. In the Republic of Korea (or Korea), the annual inflation rate was recorded at 6.9 percent in September compared with 4.5 percent for the whole of 1997. In Malaysia, it was 5.5 in September, up from the 4 percent average for 1997. In the Philippines, inflation hit 9.3 percent in September and is expected to average 9.5 percent in 1998, compared with the previous year's 5 percent.

Income Distribution and Poverty

Not all income groups are being affected proportionately. The share of wage and salary incomes in total income is likely declining, thereby altering functional income distribution. If poor households grow their own food and have some surplus for sale, their share of total income may improve if relative price changes following a devaluation favor tradable food products. Moreover, demand for agricultural labor may increase. In the Philippines, the real exchange rate depreciation during the early 1980s tended to

favor poor households. Nevertheless, an improvement in income distribution is less likely to result from a currency devaluation if the poor are predominantly agricultural laborers on land owned by the rich who have other income sources as well.

Declining levels of income and consumption per capita will lead to more immediate increases in poverty incidence (headcount ratio) and intensity (poverty gap, i.e., the average difference between the poor's per capita consumption and the poverty line). This is probable in countries where a sizable proportion of the population is close to the poverty threshold, such as Indonesia and the Philippines compared with Korea, Malaysia, and Thailand.

With the deepest contraction in GDP, Indonesia is experiencing the largest increase in poverty. According to a World Bank (1998a) estimate, a GDP shrinkage of 12 percent in 1998 (which is less than the more commonly-accepted projection of -15 percent or worse) would be accompanied by an increase in poverty rate from 11.3 percent in January 1996 to 14.1 percent in March 1999. The projected increase would be larger in urban areas (5 to 8.3 percent) than in rural areas (15 to 17.6 percent). In addition to growth effects, even modest changes in the distribution of income can have a large impact on poverty. In the Philippines, a 5 percent increase in the Gini coefficient (a summary measure of income inequality) would raise the poverty rate from 24 to 29 percent.

Human Development

The crisis has a negative impact on household investments in human development, particularly in education, health and nutrition, and fertility. First, although social services are subsidized, households still incur direct or associated costs in availing themselves of these services. With reduced incomes and higher prices (such as for medicines and school supplies), they tend to consume less than what is individually and socially optimal. Second, human capital investment takes time, which becomes scarcer as households work longer hours to cope with falling incomes. Third, the quality and quantity of government-provided services are likely to decline owing to budget reductions and massive shifts of clients from private to public providers. Fourth, as households try to maintain current levels of

consumption, they are constrained to reduce human capital investments or even deplete existing stocks.

Education. While the opportunity costs of parents' and children's time are decreasing with fewer jobs and falling wages, households need additional current income, inducing a shift of children's time from school to work. This effect tends to be strongest at levels of schooling that are least subsidized, particularly the secondary level. Notable enrollment decreases or dropouts at the secondary level, and somewhat less at the primary level, are being reported. In Indonesia, 6.1 million students are estimated to have dropped out in recent months, and in Thailand about 250,000 students. Moreover, the perceived private benefits of education have also been adversely affected. As parents observe the growing number of educated unemployed or underemployed youth, they are discouraged from spending for their children's education—an attitude that may last for a long time.

Health. The crisis also influences household demand for health care. In Indonesia, many are shifting from modern medical care to traditional healers and to self-treatment (Harris and Robb 1998). In the Philippines, because of a cut in the budget for vaccines, the extended program of immunization would be able to reach only 58 percent of DPT and polio targets and 70 percent of BCG vaccine targets (World Bank 1998b). In Thailand, higher drug prices will adversely affect the treatment of AIDS patients (Robb 1998). In the private sector, heavy foreign indebtedness and reliance on imported equipment, drugs, and supplies, in the presence of falling demand, have led to the closure of about 35 percent of private hospitals (UNDP 1998). Similarly, in Malaysia, private hospitals and clinics have reported a drop of from 15 to 50 percent in the number of patients seeking treatment (Ariff et al. 1998).

Family planning and reproductive health. In Indonesia, the cost of contraceptives has increased, and the government's family planning program now requires participants to pay for the full cost of services. Consequently, a large number of women are dropping out of the program. This is happening despite the value of family

planning services particularly in a crisis when parents are often induced to control fertility as a cost-cutting measure (although it is also conceivable that the crisis may raise the demand for children as potential income earners or security in old age). Thus, poor households may simply substitute less effective traditional ways for modern methods of fertility control. To the extent that such behavior prevails, there will likely be an increase in the number of illegal abortions or even of infanticides.

Social Capital and Environment

Social capital consists of informal norms and established relationships that enable people to pursue objectives and act in concert for common benefit. An erosion of social capital is reflected in rising crime and domestic violence, and weakening of community cooperation and participation. As well, the environment is falling victim to the crisis.

Crime and domestic violence. The struggle for survival is leading to increased criminality in communities. Stress and conflicts erupting within households over the allocation of diminishing resources are also becoming commonplace. In Jakarta, the number of divorce applications increased from 1,713 in October 1997 to 2,590 in February 1998 (Baillie 1998). The unemployed are likely to turn to the drug trade and other illegal activities in frustration, as has been reported among slum dwellers in Bangkok (Robb and Zhang 1998). In Mindanao, communities have reported that crime has risen since the crisis began. In one community, a curfew has been introduced for the first time in response to increased crime. Rising prostitution of women and children, as well as increased numbers of street children, drug peddling, and domestic violence, have also been reported in the Philippines. In Bangkok, attacks against debtors by "loan sharks" who had not been repaid have also been recorded (Robb 1998).

Community cooperation and participation. The crisis appears to have diminished the spirit of community cooperation and trust, replacing it with an attitude of intense competition for limited re-

sources. A focus group in Teparak, Thailand reported a breakdown in community trust within the last six months (Robb 1998). With greater competition for limited jobs, neighbors now appear hostile to one another.

Environment. While economic recession may provide some respite to the environment, household attempts to obtain additional income, along with efforts of unemployed urban workers to find rural employment, often lead to increased environmental destruction, such as deforestation, erosion, and overfishing. In Thailand, the devaluation of the baht has provided strong stimulus to agricultural exports, resulting in expansion and intensification of shrimp farming and, hence, destruction of wetlands and increased salinity of rice lands. An increase in illegal logging in Thailand and in neighboring Cambodia and Burma has also been noted.

Vulnerable Groups

Women. Being largely secondary earners and not belonging to labor unions, female workers are more likely to lose their jobs than their male counterparts. In Thailand, women accounted for slightly more than half of reported layoffs between January 1997 and February 1998 (ILO 1998a). In the Philippines, women are expected to account for a high proportion of the expected 46,000 to 105,000 returning overseas migrant workers in 1998 and 1999 (Bohning 1998). Women often get a smaller share of the more limited household food supply, such that their health suffers with the stress of family care and additional work that is part of the household's coping mechanism. Likewise, female children are more likely to be kept out of school to care for younger children and to perform other household chores as parents increase their participation in the labor market.

Children. Children also tend to fare poorly in the competition for the household's diminishing resources. In Indonesia and the Philippines, teachers have reported that children are eating less before coming to school, thereby adversely affecting their ability to concentrate (Atinc and Walton 1998). Many children are dropping

out of school to work either at home or outside often in hazardous activities (e.g., begging and child prostitution). Children are also likely to be neglected by busy parents trying hard to make ends meet.

Youth. Youth unemployment rates are rising faster than those of adults. This undoubtedly leads to deeper frustration and possibly contribute to political instability. In Korea, partly due to legal restrictions on layoffs, many employers have imposed recruitment bans. As a result, youth unemployment rates have risen to 7.4 percent and 11.8 percent in the 20-24 and 15-19 age groups during the last quarter of 1997 from 5.9 and 7.5 percent, respectively, in the previous year (ILO 1998a). The corresponding increase in the national average unemployment rate was 2.0 to 2.6 percent.

Older persons. With incomes that tend to be fixed, older people are especially vulnerable to the effects of inflation. In an Asian setting, they can probably expect to receive their fair share of even limited household resources. However, the additional demands placed on the time of younger household members may deprive them of needed care.

Factory workers. With the severe negative impact of the crisis on the manufacturing sector, factory workers are particularly vulnerable to layoffs. In the Philippines, 65 percent of the workers laid off during the first quarter of 1998 were from the manufacturing sector (Lim 1998). Most factory workers also live in urban areas, where the cost of living is higher, and have to purchase virtually all the food needs of their families.

Construction workers. Construction workers are also vulnerable because of the sharp downturn in construction activities. In the Philippines, construction declined by 4.4 percent during the first quarter of 1998, compared with a growth of 21.3 percent during the first quarter of 1997 (Lim 1998). In Thailand, construction workers accounted for 60 percent of reported layoffs during the third and fourth quarters of 1997, although they represented only 35 percent of total employment (ILO 1998a). These workers largely come from

among the poorest. In the Philippines, 21 percent of construction workers are estimated to be poor, compared with only 10 percent of manufacturing workers, 9 percent of trade workers, and 14 percent of service workers (Balisacan 1997).

Service workers. There is wide variation in the effects of the crisis on service sector workers. Those in the tourist or allied sectors (e.g., retail sales, restaurants, transportation) may be relatively unaffected by declining employment and income. However, many service workers are in the informal sector, working as own-account or family workers. They can expect to face decreases in income as employment contracts with declining sales and rising input prices.

White-collar workers. Employees in the financial sector were among the first to be directly hit by the currency crisis in Thailand and Indonesia owing to the closure of failed banks and financial companies or their subsequent restructuring. Retrenchment of white-collar workers in other sectors soon followed as the crisis spread. Nonetheless, this class of workers is not likely to slip into poverty so easily, given their higher levels of education and resiliency. Many have managed to find other, if less well-paying, jobs, or have succeeded in setting up small businesses. However, feelings of frustration and desperation among these workers are deep, leading to some suicides, as reported in Korea and Indonesia.

Farm workers. Farm workers (as opposed to self-employed farmers) are typically heavily represented among the poor. They have to compete for work with unemployed workers from other sectors. In normal times, many farmers move to urban areas to live with relatives and work for a few months in order to supplement their farm incomes. This year there has been little temporary rural-to-urban migration due to the high rates of urban unemployment. At the same time, there has been less crop cultivation in rural areas due to the effects of the El Niño drought, besides higher prices of agricultural inputs.

Overseas migrant workers. Overseas migrants working in other Asian countries are being seriously affected by the crisis (e.g.,

Indonesians in Malaysia, Burmese in Thailand, Filipinos in Korea and Malaysia). Several have been forced to return to their home countries, and some have been subjected to attempts by corrupt officials to extort payments at border crossings (e.g., Burmese workers returning from Thailand).

Ethnic minorities. Latent and deep animosities toward certain ethnic groups have resurfaced as a consequence of the crisis. They have been severely victimized as scapegoats for the miseries of the more dominant segments of society. The misfortune that has befallen the ethnic Chinese in Indonesia exemplifies this social impact.

Responses to the Crisis

Household Coping Mechanisms

Responses at the household level typically include adjustments in consumption, saving and labor supply behavior, besides utilization of social services.

Consumption and saving. Households tend to consume less of everything when their incomes decline ("income effect") and purchase less of items whose relative prices have increased ("substitution effect"). In fact, households are reducing their food expenditure, reflecting both effects. Within the food budget, households are substituting cheaper, lower-quality sources of calories (cereals, roots, tubers) for more expensive, higher-quality sources (meat, fish, fruit, and vegetables). Moreover, by selling or pawning assets, taking salary advances, or borrowing money, households are dissaving.

Labor supply and migration. Households also substitute income-earning activities for nonincome-earning ones. Another option is for some or all members of the household to migrate to where income-earning opportunities and/or cost of living are more favorable. In Thailand, it was reported that 188,000 workers had returned to rural areas, with the highest return-migration rates observed in the depressed northeast region of the country (Royal Thai Government 1998). In instances where only some members migrate, a breakup of the household often entails added social costs.

Community Responses

Some communities have adopted cooperative solutions to deal with the crisis. In Khon Kaen (Thailand), people in urban slums are linking closer with their rural contacts to obtain food at affordable prices (Robb and Zhang 1998). In Davao (Philippines), a community savings scheme was set up so that everyone could contribute to a common fund to cover the cost of festivals; a community policing scheme was introduced in response to increased crime; and teachers formed a cooperative to borrow money from the government at lower rates (World Bank 1998b). In Indonesia, some employers and landlords are reported to have voluntarily retained employees and tenants at reduced wages and rents (Harris and Robb 1998).

Labor-Management Responses

Although many businesses are responding to falling market demand by simply laying off workers, there are numerous instances of labor and management working together to minimize the social impact. In Korea, a survey of 400 enterprises found that 52 percent of the firms imposed a freeze on new recruitment, 17 percent used early retirement, and 14 percent resorted to reduced number of work hours (ILO 1998a). The same survey found that 45 percent of unions were willing to accept a wage freeze and 3 percent, wage reductions, if employers would guarantee job security. In the Philippines, trade unions and employers reached an agreement in February 1998 to protect employment in return for a wage freeze. The government has also been effective in persuading employers to allow adjustments in real wages to control labor costs instead of resorting to layoffs.

Government Responses

Governments have responded in various ways by enforcing legislation regarding severance pay and unemployment insurance, and fostering job retraining programs and employment services. Other responses are in the form of pension and provident funds, income maintenance programs, and subsidies to food and fuel and to social services.

The coverage of severance pay varies considerably. Moreover, under difficult economic conditions, severance pay is often not actually paid. Similarly, of the crisis-hit countries, only Korea has an unemployment insurance program, but it is of recent origin and provides only limited coverage and limited duration of benefits (ILO 1998a).

Korea has extensive vocational training and employment services networks. However, the resources and institutional capabilities of the latter may be inadequate for the massive requirements of the current crisis; the job placement system is designed to handle about 300,000 unemployed workers, compared to the 1.5 million it is attempting to deal with at present. In the Philippines, social security funds in the amount of ₱ 300 million were used to fund a program providing low-interest loans for the retraining of unemployed workers (Lim 1998). In Thailand, a center for assistance to laid-off workers was set up shortly after the onset of the crisis.

Pensions can be an important source of support to older workers who lose their jobs, and early retirement benefits can facilitate relatively painless reductions in the work force. However, few workers in the crisis-hit countries participate in pension plans. Somewhat more widely available are provident funds (savings plans belonging to individual workers). Nevertheless, although these funds have in some cases been used in the wake of the crisis (e.g., in Indonesia, workers are permitted to withdraw funds if they have been members for 5 years and unemployed for six months), their average value is typically quite small and has been further eroded by inflation. In Thailand, the Labour Protection Act of January 1998 provides for the establishment of a welfare fund for employees in enterprises with ten or more workers.

Direct cash payments, loans, or distribution of food to poor families can be an effective way for governments to administer a social safety net. In Korea, for example, the government provides loans to the unemployed to cover general living expenses (ILO 1998a). In the Philippines, the Department of Social Welfare and Development administers a program of cash transfers to the poor, but the total budget amounts to only 1/70th of the education budget (World Bank 1998b). In the absence of accurate household targeting, the cost of transferring income to the poor can be quite

high. In Indonesia, for example, untargeted cash transfers are estimated to cost almost \$8 for each \$1 actually received by the poor (Atinc and Walton 1998).

A practical alternative to cash and in-kind grants and loans is public works schemes. Korea is using such a program to respond to the needs of those unemployed who are outside the scope of its unemployment benefits system. Similarly, Indonesia has developed large programs of labor-intensive public works. For 1998/99 these programs are budgeted at US\$2 billion and are expected to generate 2 million person-years of employment (ILO 1998b). In principle, the use of a uniformly low wage (equal to 75 percent of the minimum wage in Indonesia) ensures that mainly the poor are attracted to such programs. It has been estimated that it costs \$4-5 to transfer \$1 to the poor under these programs, compared with almost \$8 through untargeted cash transfers.

Food and fuel subsidies have been widely used in Indonesia as a component of the social safety net. The problem with these subsidies, however, apart from the resultant market distortions and heavy fiscal burden, is that they are poorly targeted. It is difficult to find items to subsidize that are at once important to the poor and yet are not also consumed by middle- and upper-income groups. Even in the case of rice subsidies in Indonesia, where rice alone absorbs 30 percent of the spending of the poorest decile of the population, the World Bank (1998a) estimates that it costs \$8.20 to transfer \$1 to the poor. However, if such subsidies were instead provided to low-quality foods consumed mainly by the poor, the cost would fall to \$3.60 per \$1 transferred to the poor.

Government health insurance programs exist in most of the crisis countries, but only a part of the population is covered by these programs. In Korea, where coverage is highest, health insurance still covers only about 50 percent of hospital costs (ILO 1998a). In both Korea and Thailand, there are provisions to continue health insurance coverage for unemployed workers.

International Responses

Apart from the IMF packages consisting of programs of economic support and reform, to which other multilateral and bilateral

donors have contributed, there have been programs of assistance specifically addressing the social impact of the crisis. The ADB is providing a social protection sector development program to Indonesia and a social sector program to Thailand. In Indonesia, the ADB and the World Bank have worked with the government and UNICEF to develop an innovative program of loans and scholarships to assist parents of secondary school students to keep their children in school. Also, despite the absence of an IMF program, the World Bank is extending to Malaysia a \$300 million loan (with an additional \$700 million loan expected to follow) to support the social sector component of the its economic reform package. Moreover, UN agencies have been involved in responding to the social impact of the crisis.

Conclusion

It seems clear that the evolving social crisis is both massive and potentially long-lasting. This is because the Asian financial and economic crisis, underpinned by structural problems, is more difficult to overcome than, say, the Mexican crisis that was caused by macroeconomic imbalances.

The Bank's ongoing regional technical assistance study intends to provide a more comprehensive assessment of the social impact. In addition to standard socioeconomic analysis that tends to rely on quantitative macro and sectoral data, the study will undertake qualitative micro-level (household and community) assessments using participatory approaches in the affected countries. This latter part of the study is intended to complement the former in providing details that typically escape the standard economic approach.

With a more thorough understanding of the social crisis, it should be possible to better assist in devising responses and actions that would strengthen social protection systems. More generally, it should be possible to indicate critical reforms in the social sectors that would contribute to improving the prospects of long-term social development in Asian developing countries.

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